Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	

RURAL TASK FORCE RECOMMENDATION TO THE FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE

Adopted: September 22, 2000 **Released: September 29, 2000**

By the Rural Task Force:

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I. EXECUTIVE SUMMARY

This document contains a comprehensive, balanced package that is the final Recommendation (Recommendation) of the Rural Task Force (Task Force). The Task Force was appointed by the Federal-State Joint Board on Universal Service (Joint Board) in CC Docket No. 96-45 pursuant to the Telecommunications Act of 1996 (1996 Act).[1] We urge that the Recommendation be implemented immediately and remain in place for five years. Plans should be made to reevaluate appropriate universal service funding approaches for areas served by "rural telephone companies"[2] prior to the end of the five-year period. The Recommendation represents the consensus of individual Task Force members.[3] The Recommendation may or may not represent the positions of organizations or companies to which Task Force members belong.

The Task Force has expended considerable time over the past two years in learning, discussing, debating, negotiating, and compromising to develop this Recommendation. As a delicately-crafted package, it is meant to balance the mandate to preserve and advance universal service while at the same time facilitating competition in areas served by Rural Carriers. The Recommendation also strikes a careful balance between the need to provide a fund that is "sufficient" under the provisions of the 1996 Act while insuring that the overall size of the fund is reasonable. Each of the elements of this comprehensive package are interdependent and should be considered in concert with each other, and should be implemented expeditiously. The Task Force strongly recommends that this balance be honored in reviewing the complete package that comprises its Recommendation.

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[1] Pub. L. No. 104-104, 110 Stat. 56 (1996 Act). The 1996 Act amended the Communications Act of 1934, 47 U.S.C. Section 151 *et seq.* (1996 Act).

[2] "Rural telephone company" means a local exchange carrier operating entity to the extent that such entity-- (A) provides common carrier service to any local exchange carrier study area that does not include either-- (i) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or (ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993; (B) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines; (C) provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or (D) has less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the Telecommunications Act of 1996 (47 U.S.C. Section 153 (37)). The term "Rural Carrier" as used in this Recommendation is meant to include carriers serving insular areas and to incorporate the statutory definition of "rural telephone company" as applied in the FCC rules. *See* In re: Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Report and Order* (rel. May 8, 1997) at paragraph 96. *See also* FCC *Public Notice*, CC Docket No. 96-45, DA 98-1205 (rel. June 22, 1998) lists recognized self-certified "Rural Telephone Companies." This list is updated periodically. S*ee* for example, FCC *Public Notice*, CC Docket No. 96-45, DA001705 (rel. Aug. 1, 2000).

[3] Several appointees were not present or involved during the final months of meetings and conference calls of the Task Force. Because they did not take part in the final deliberations and because the Task Force had agreed early on that they must be present to vote, several appointees' names do not appear on the Recommendation signature page.

The following summarizes the major conclusions of the Task Force:

- The Task Force's Recommendation should be implemented immediately and remain in place for a five-year period. Plans should be made to reevaluate appropriate universal service funding approaches for areas served by Rural Carriers prior to the end of this five-year period.

- The Task Force recommends that the Synthesis Model not be used for determining the forward-looking costs of Rural Carriers.

- The Task Force recommends the Modified Embedded Cost Mechanism of federal universal service support for Rural Carriers be adopted for sizing the Rural Carrier federal universal service fund.

- The Task Force recommends a flexible system for disaggregating support to establish the portable per line support available to all eligible telecommunications carriers with timely distributions.

- The Task Force recommends that states be delegated responsibility for oversight of the use of universal service support in a manner similar to that used for the non-rural LECs.

- The Task Force recommends that the Joint Board review the definition of the services that are supported by federal universal service support mechanisms, and that a "no barriers to advanced services" policy be adopted.

- The Task Force recommends the Joint Board and Federal Communications Commission (FCC) enact modifications to the caps and limitations on universal service funding which currently exist:

    - The High Cost Loop Fund should be re-based by increasing it $118.5 million, grown by an annual factor, and include a "safety net;"

    - The corporate operations expense limitation should be adjusted for growth; and

    - A "safety valve mechanism" should be added to the limitation on support for acquired or transferred exchanges.

- The Task Force recommends a set of principles to be used in addressing implicit support in interstate access charges, and recommends creation of High Cost Fund III to take the place of any implicit support removed from interstate access.

II. CONTEXT AND EVIDENTIARY FOUNDATION

A. Overview

Shortly after its formal organization in July of 1998, the Task Force developed a mission statement, working objectives and guiding principles for its ultimate recommendation to the Joint Board. Specifically, the Task Force clarified its mission " . . . to review and evaluate alternative universal support mechanisms which affect consumers in rural and insular areas served by rural telephone companies and to make recommendations to the CC 96-45 Joint Board on appropriate universal service support mechanisms, methods and policies to faithfully implement the universal service provisions of the Telecommunications Act of 1996 for these rural and insular areas."[4]

Three specific objectives were established to guide the work of the Task Force:

1. The Task Force should review a broad range of options, including the continuation or adaptation of the current system of support, a system of support based on forward-looking cost models, and any other mechanism consistent with the universal service support and pro-competitive provisions of the 1996 Act;

2. The Task Force should identify issues that are unique to carriers that serve rural or insular areas and recommend means to address those unique characteristics; and

3. Where necessary, the Task Force should recommend transitional mechanisms, hold harmless provisions, or modifications to minimize adverse impacts to rural or insular consumers and to facilitate investment in modern telecommunications infrastructure by service providers serving rural and insular areas.

These three objectives formed the work plan underlying the Recommendation described in this final report. In preparing this Recommendation, the Task Force has also relied on three broad principles established during its early organizational phase. First, the Recommendation must conform to the universal service principles established by Congress in Section 254(b) of the 1996

[4] *See* "Mission Statement, Objectives and Principles for Developing a Recommendation", adopted by the Task Force December 12, 1998, available at www.wutc.wa.gov/rtf.

Act.[5] Second, any support mechanism recommended by the Task Force must be economically and administratively workable. Third, the Recommendation must be consistent with extending benefits of competitive telecommunications markets to rural and insular areas and with the principle of competitive neutrality. We believe that this final Recommendation to the Joint Board is consistent with these three guiding principles.

In its deliberations, the Task Force has utilized an open, collegial process, involving not only its members, but also a diverse group of interested stakeholders. In general, the Task Force has developed its Recommendation through consensus rather than hard votes around alternative positions. This approach is pragmatic, and it is intended to deliver to the Joint Board a package of recommendations with the potential of being implemented promptly and without legal challenge from affected parties. We observe that while every party has a right to challenge regulatory decisions through appropriate legal avenues, such challenges ultimately result in uncertainty for all parties. Uncertainty over available universal service support ultimately discourages investment in high cost rural areas by both ILECs and CLECs.[6] Our Recommendation builds on the strengths of the Task Force members by developing an up-front consensus among a diverse group of stakeholders on an appropriate universal service mechanism for Rural Carriers.

The Recommendation has its foundation in a deliberate written evidentiary record. That record has been assembled in the form of six white papers available on the Rural Task Force web page.[7] Within this final report to the Joint Board, the Task Force will cite and develop appropriate linkages to the written evidentiary record contained in these white papers, as well as to the foundation laid by the 1996 Act and FCC policy documents.

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[5] (1) QUALITY AND RATES.--Quality services should be available at just, reasonable, and affordable rates. (2) ACCESS TO ADVANCED SERVICES.--Access to advanced telecommunications and information services should be provided in all regions of the Nation. (3) ACCESS IN RURAL AND HIGH COST AREAS.--Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas. (4) EQUITABLE AND NONDISCRIMINATORY CONTRIBUTIONS.--All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service. (5) SPECIFIC AND PREDICTABLE SUPPORT MECHANISMS.--There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service. (6) ACCESS TO ADVANCED TELECOMMUNICATIONS SERVICES FOR SCHOOLS, HEALTH CARE, AND LIBRARIES.--Elementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services as described in subsection (h). (7) ADDITIONAL PRINCIPLES.--Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act.

[6] "ILEC" means incumbent local exchange company; "CLEC" means competitive local exchange company. As used in the Recommendation, we intend to include all competitive service providers, including wireless carriers, in the term CLEC.

[7] *See* www.wutc.wa.gov/rtf. For any references to Task Force white papers hereafter, please refer to the Task Force web pages for copies.

B. Legal and Policy Foundation for the Task Force Recommendation

Early in its process, the Task Force reached consensus on the legal and policy foundation underlying this Recommendation on the appropriate universal service mechanism and policies for universal service in areas served by Rural Carriers. That consensus was formalized in the Task Force's first White Paper entitled, "Rural Task Force Mission and Purpose," published December 1998.

The Task Force recognizes that many of the nation's rural communities are currently served by ILECs and CLECs that provide service to high-cost areas served by non-Rural Carriers. The universal service support needs of these communities were addressed by the FCC in November 1999.[8]

This Recommendation specifically addresses the universal service support needs of the remaining rural, insular and high cost communities currently served by Rural Carriers and CLECs serving those same areas. Both the 1996 Act and statements by the FCC make clear that the universal service mechanism, as well as policies applied in implementing that mechanism for Rural Carriers, may be appropriately different than those adopted for non-Rural Carriers.[9] The Task Force's White Paper 1 provides a complete record detailing relevant citations from the 1996 Act and FCC orders. For purposes of establishing a foundation for this Recommendation, we highlight only a few of the key legal and policy citations in this document.

An essential foundation to our Recommendation is the statutory framework and underlying national policy objectives enacted by Congress in the 1996 Act. The Recommendation considers all relevant provisions of the law including those consistent with extending the benefits of a competitive telecommunications market to rural or insular areas along with the principle of competitive neutrality. However, the heart of the Congressional directive is contained in the universal service principles of Section 254.

The 1996 Act's universal service policies articulated in Section 254(b) generally ensure that all individuals and businesses will have the opportunity to share not only the benefits of a nationwide telephone network, but also the benefits generated by the ongoing global transformation of the availability and uses of information.[10] The 1996 Act broadens the traditional concept of universally available quality telephone service at just, reasonable and affordable rates to include a commitment to make available access to advanced telecommunications and information services "…in all regions of the Nation."[11] The law requires the FCC and the Joint Board to define the services that will receive federal support. The 1996 Act also institutes a program for ensuring nationwide progress as telecommunications and information development unfolds, by requiring regular reexamination of an evolving definition of universal service pursuant to Section 254(c).

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[8] In re: Federal-State Universal Service Joint Board, CC Docket No. 96-45 *Ninth Report and Order and Eighteenth Order on Reconsideration* (rel. Nov. 2, 1999). This order will be referred to hereinafter as the "Non-Rural Order."
[9] Id. Non-Rural Order at paragraph 11.
[10] The Task Force notes the parallel language of Section 706 of the 1996 Act, 47 U.S.C. 157.
[11] The 1996 Act also provides for discounts for schools, libraries and rural health care providers and support for low-income consumers.

Section 254(d) of the 1996 Act requires all carriers that provide interstate service to contribute on an equitable and non-discriminatory basis to support the costs of ensuring nationwide service and network development at affordable and reasonably comparable rates. As a result, the federal mechanism was intended to spread the burden of maintaining and advancing a nationwide public switched network across all carriers and their customers. [12] Section 254(f) provides that a state may adopt regulations not inconsistent with the FCC's rules to preserve and advance universal service. A state may adopt regulations providing additional definitions and standards to preserve and advance universal service within that state only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

The 1996 Act expressly sets a standard of adequacy for the federal universal support program in that the support "should be explicit and sufficient to achieve the purposes of this section." Sufficiency of support must be gauged against the standards embodied in the universal service principles set forth in Section 254(b).

The 1996 Act also sets standards to prevent waste, windfalls and excessive expense for contributing carriers and their customers. Support may be provided only to a carrier designated as eligible pursuant to Section 214(e). In addition, Section 254(e) provides that any carrier that receives federal support "shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." Finally, services that are not competitive should "bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."[13]

The principles in Section 254(b) spell out the results Congress expects to achieve with the universal service mechanisms. Congress also allowed the Joint Board and the FCC to adopt additional principles they found are "necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act."[14] In its May 8, 1997, Universal Service Order the FCC added the principle of competitive neutrality for support mechanisms, which the Task Force took into account in framing its recommendations.[15]

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[12] Section 254 (b) (4) of the 1996 Act establishes the principal that "all providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." Section 254 (d) establishes the obligation that "every telecommunications carrier that provides interstate telecommunications services shall contribute on an equitable and nondiscriminatory basis, to the specific, predictable and sufficient mechanisms established by the Commission to preserve and advance universal service." That section also gives the Commission the authority to exempt *de minimis* contributions and require contributions from "any other provider of interstate telecommunications." The law does not distinguish between interstate and intrastate revenues but requires all carriers to contribute. In addition, the act defines the term "telecommunications" broadly. The Task Force recommends in order to help ensure the long term stability of universal service funding that universal service support contributions should be assessed on the broadest possible base.

[13] Section 254(k) of the 1996 Act.

[14] Section 254(b)(7) of the 1996 Act.

[15] The FCC recognized, however, that given the complexities and diversity of the telecommunications marketplace, it would be extremely difficult to achieve strict competitive neutrality. *See* In re: Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Report and Order* (rel. May 8, 1997) at Paragraph 48.

While the universal service principles of the 1996 Act apply equally to Rural Carriers and non-Rural Carriers, Congress explicitly recognized in the 1996 Act that policies pertaining to competitive entry and universal service reform for the "rural telephone companies" may be appropriately different than for other companies. The 1996 Act gives state commissions a degree of latitude to make determinations about which carriers are eligible to receive support based on local circumstances affecting the pace and impact of competitive entry and universal service reform.

Section 214(e)(2) of the 1996 Act gives state commissions a role in deciding whether to designate multiple providers as eligible telecommunications carriers (ETCs) able to receive support for providing federally-defined universal service in an area served by a Rural Carrier.[16] Before designating an additional ETC for an area served by a Rural Carrier, the state commission is required to find that the designation is in the public interest. Section 214(e)(5) defines the term "service area" for the purpose of determining universal service obligations. For areas served by Rural Carriers, this section adds the requirement that an ETC must serve the ILEC's entire study area[17] unless and until the FCC and the states, after taking into account recommendations of the Joint Board, establish a different definition of service area for each company.

Section 251(f)(1) of the 1996 Act exempts Rural Carriers from certain duties to interconnect and provide unbundled network access that apply to other non-rural ILECs. State commissions must evaluate any *bona fide* request to a Rural Carrier for interconnection or network elements to ensure that the request is not unduly economically burdensome, is technically feasible, and is consistent with Section 254.

For an area served by a Rural Carrier, Section 253(f) permits a state commission to require a CLEC to be an ETC as a condition of providing telephone exchange service or exchange access in a Rural Carrier's service area.[18] In effect, the law requires the state commission to examine public interest questions concerning a Rural Carrier's study area. By including this provision Congress recognized that unrestricted entry may not be beneficial to consumers in some rural ILEC areas. At the same time, Congress did not intend to deny rural consumers the benefits of competition when the state determines that competition is in the public interest. Notably, Congress did not place similar restrictions on areas served by non-Rural Carriers. This demonstrates a decision by Congress to allow policies pertaining to competitive entry and universal service reform for Rural Carriers to be appropriately different than for non-Rural Carriers.

The Task Force notes that recent Joint Board recommendations and FCC orders also recognize appropriate universal service mechanisms and policies for Rural Carriers may differ from

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[16] The FCC has not adopted rate or service obligations for competitive ETCs (CETCs).

[17] A "study area" is generally the entire territory within a single state served by a telephone company.

[18] Section 253 of the 1996 Act. [47 U.S.C. 253] REMOVAL OF BARRIERS TO ENTRY (f) RURAL MARKETS.--It shall not be a violation of this section for a State to require a telecommunications carrier that seeks to provide telephone exchange service or exchange access in a service area served by a rural telephone company to meet the requirements in Section 214(e)(1) for designation as an eligible telecommunications carrier for that area before being permitted to provide such service. This subsection shall not apply--(1) to a service area served by a rural telephone company that has obtained an exemption, suspension, or modification of Section 251(c)(4) that effectively prevents a competitor from meeting the requirements of Section 214(e)(1); and (2) to a provider of commercial mobile services.

those adopted for non-Rural Carriers. For example, the Joint Board on Universal Service officially moderated its commitment to using a universal service support mechanism based on forward-looking economic cost (FLEC) for the Rural Carriers, even as it moved toward implementing such a support system for non-Rural Carriers. The Joint Board's Second Recommended Decision cautions that "in recommending this framework for determining non-rural carriers' high cost support based on forward-looking cost, we do not intend for the FCC to create any precedent for any potential revisions to support mechanisms for rural carriers."[19] This important aspect of the Joint Board's Second Recommended Decision was adopted and expanded upon by the FCC in its Non-Rural Order adopting the FLEC proxy cost model for non-Rural Carriers.[20]

Rural and insular differences have been a principal reason for delay of access reform for rate-of-return regulated ILECS. These differences convinced the FCC that it should not implement reform for the primarily small and rural rate-of-return regulated ILECs in the same manner, or at the same time, that it reformed access charges for the larger price cap-regulated carriers. On May 26, 1998, the FCC opened a separate access reform proceeding for rate-of-return-regulated ILECs. In the Notice of Proposed Rulemaking (NPRM), the FCC acknowledged that rate-of-return-regulated ILECs face significantly higher costs and recover a much larger percentage of their total revenues from access charges than do price cap-regulated ILECs.[21] The FCC also acknowledged the substantial differences among rate-of-return-regulated carriers, stating that "[t]hey are not, however, a homogenous group, and their operating conditions vary significantly."[22] These different circumstances, the FCC recognized, "may require different approaches to reform, including a different transition to more economically efficient, cost-based interstate access charges."[23]

C. Empirical Justification for a Distinct Rural Carrier Universal Service Mechanism

Congress, the FCC and the Joint Board have each concluded that universal service mechanisms and policies applying such mechanisms must be flexible in recognition that market and operational factors associated with Rural Carriers may be substantially different from those associated with non-Rural Carriers. For the most part, however, the precise scope and magnitude of those differences had not been documented. Recognizing this gap in the evidentiary record, the Task Force undertook a detailed study of the "rural differences." Conclusions from that study are summarized in White Paper 2, "The Rural Difference," released by the Task Force in January

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[19] In re: Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Second Recommended Decision* (rel. Nov. 25, 1998) at Paragraph 30.

[20] "The support mechanism for rural carriers will remain unchanged at least until January 1, 2001, and reform will be undertaken only after the Commission, the Joint Board, and a Rural Task Force appointed by the Joint Board have selected an appropriate methodology for rural support." Non-Rural Order at Paragraph 11.

[21] Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, *Notice of Proposed Rulemaking*, FCC 98-101 (rel. June 4, 1998), Paragraphs 16 and 35 (Rate-of-Return Access NPRM).

[22] *Id.*, Paragraph 14.

[23] *Id.*, Paragraph 4.

2000.[24] White Paper 2 analyzes publicly available national data assembled for the first time, to systematically compare and contrast Rural Carriers and non-Rural Carriers. Equally important, the analysis conducted by the Task Force documents a substantial diversity among Rural Carriers themselves. An understanding of the differences between Rural Carriers and non-Rural Carriers and the diversity among Rural Carriers is key to designing appropriate mechanisms and policies which will allow the fulfillment of the 1996 Act's universal service principles.

The following are major Rural Carrier differences identified by the Task Force and described in White Paper 2:

Rural Carriers serve more sparsely populated areas

- Both Rural Carriers and non-Rural Carriers serve rural communities. However, Rural Carriers' operations tend to be focused in the more geographically remote areas of the nation with widely dispersed populations.

- Nationwide, Rural Carriers serve about eight percent of the nation's access lines, 38 percent of the nation's land area, and 93 percent of the study areas.

- The average population density is only 13 persons per square mile for areas served by Rural Carriers compared with 105 persons per square mile in areas served by non-Rural Carriers.

- Evaluating proxy cost model output for a representative sample of ten states, Rural Carriers serve 70 percent of the modeled serving areas with fewer than five lines per carrier serving area, but only ten percent of the modeled serving areas with over 100 lines per carrier serving area.

There is significant variation in study area sizes and customer bases among Rural Carriers

- The vast majority of access lines served by Rural Carriers are clustered in the largest study areas in terms of line size.

- Rural Carriers serving the three smallest study area groupings (2,500 lines or less) encompass 48 percent of all study areas in terms of line size, but only five percent of all access lines served by Rural Carriers. On the other hand, Rural Carriers serving the three largest study area groupings (20,000 lines or more) contain only 10.5 percent of all study areas, but 67 percent of all Rural Carrier access lines.

- The average population density of areas served by Rural Carriers varies dramatically. Rural Carriers in Alaska and Wyoming serve populations of 0.58 and 1.25 persons per square mile respectively, while Rural Carriers in some states serve populations of over 100 persons per square mile.

[24] *See* www.wutc.wa.gov/rtf.

Isolation of areas served by Rural Carriers results in numerous operational challenges

- Rural Carriers have relatively high loop costs because of the lack of economies of scale and density.
- Rural Carriers experience difficulty and high cost in moving personnel, equipment and supplies to remote and insular communities.
- Geographic surface conditions - such as coral, volcanic rock and permafrost - require expensive specialized outside plant construction practices.
- More resources, including duplicate facilities and backup equipment are required to protect network reliability.

Compared to non-Rural Carriers, the customer base of Rural Carriers generally includes fewer high-volume users, depriving Rural Carriers of economies of scale

- On average, multi-line business customers represent about 13 percent of total business lines served by Rural Carriers compared to over 21 percent of the lines served by non-Rural Carriers.
- Non-Rural Carrier study areas typically have higher business customer density than Rural Carrier study areas.
- On average, special access services purchased by large users only represent about three percent of total interstate revenues for Rural Carriers compared to nearly 18 percent for non-Rural Carriers.
- There is substantial diversity among Rural Carriers in providing special access service to customers. Interstate special access revenues compared to total interstate revenues for Rural Carriers range from zero to 36 percent.

Compared to customers of non-Rural Carriers, customers of Rural Carriers tend to have a relatively small local calling scope and make proportionately more toll calls

- On average, local minutes comprise 85 percent of total intrastate minutes for non-Rural Carriers, but only about 69 percent of total intrastate minutes for Rural Carriers.
- Rural Carriers have a higher average proportion of interstate toll minutes to total minutes (21 percent) than non-Rural Carriers (16 percent).
- Seventy to 80 percent of customers of smaller Rural Carriers can reach less than 5,000 other customers with a local call. Only 10 percent of smaller Rural Carriers have local calling capability to reach as many as 25,000 other subscribers.

Rural Carriers frequently have substantially fewer lines per switch than do non-Rural Carriers, providing fewer customers over which to spread high fixed network costs

- On average, Rural Carriers have only 1,254 customers per switch compared to over 7,000 customers per switch for non-Rural Carriers.

- For Rural Carriers, the number of lines per switch decreases dramatically as the line size of the study area served decreases. Rural Carrier study areas with more than 100,000 lines average nearly 3,000 lines per switch, compared to an average of only 223 lines per switch for study areas with less than 500 lines.

Total investment in plant per loop is substantially higher for Rural Carriers than for non-Rural Carriers

- On average, total plant investment per loop is over $5,000 for Rural Carriers compared to less than $3,000 for non-Rural Carriers.

- Average total plant investment per line for Rural Carriers increases as the line size of the study area decreases. Average total plant investment per line ranges from $3,000 for Rural Carriers with the largest study areas to over $10,000 for Rural Carriers with the smallest study areas.

- The range of values for total plant investment per loop for Rural Carriers ($1,400 to $40,500) is far greater than the range for non-Rural Carriers ($1,570 to $4,350).

Plant specific and operations expenses for Rural Carriers tend to be substantially higher than for non-Rural Carriers

- On average, plant specific expenses per loop are $180 for Rural Carriers compared to $97 per loop for non-Rural Carriers.

- Average Rural Carrier plant specific expenses increase consistently as the number of lines served decreases, from approximately $110 per loop for carriers with more than 20,000 lines to $445 per loop for carriers with study areas having less than 500 lines.

- The range of total plant specific expenses per loop for Rural Carriers ($4 to $1,585) is substantially greater than for non-Rural Carriers ($38 to $163).

- Depreciation expenses and corporate operations expenses per loop tend to follow similar trends as plant specific expenses, that is, they increase as the number of lines served decreases.

Customers served by Rural Carriers have different demographic characteristics from customers in areas served by non-Rural Carriers

- 1990 U.S. Census data indicates the average annual household income for customers in Rural Carrier Service areas was $31,211, twenty percent lower than that of non-Rural Carrier customers ($38,983).

- Native Americans are disproportionately represented among those without phone service. Rural Carriers serve a higher percentage of Native American customers than non-Rural Carriers.[25]

- The Kindergarten – 12th Grade school is the point of Internet access for 30 percent of persons in rural areas, compared to only 21.8 percent for the nation as a whole.[26]

In passing the 1996 Act, Congress was clear that we are one nation, and that national universal service policy must ensure that the benefits of telecommunications industry reform accrue to all Americans, including those in remote, rural and insular regions. The evidentiary record assembled by the Task Force clearly supports a conclusion that a "one-size-fits-all" national universal service policy is unlikely to be successful in fulfilling the national universal service principles contained in the 1996 Act. To be successful, the policies and mechanisms ultimately adopted must be flexible enough to accommodate the wide range of market and operational circumstances faced by telecommunications carriers serving rural populations. This observation, grounded in empirical evidence, is fundamental to the choices and recommendations advanced by the Task Force.

D. Policy Context Facilitating Both ILEC and CLEC Investment in Rural Communities

A high quality telecommunications infrastructure is necessary in order to provide for the economic, educational, health care and other opportunities essential to the future vitality of our rural communities. The Task Force reached agreement that a primary purpose of universal service support is to promote investment by both ILECs and CLECs in rural America's telecommunications infrastructure. This investment is necessary to ensure universal access to telecommunications services which are comparable to those available in urban areas, and to provide a platform for delivery of advanced services.

A universal service system which delivers sufficient support should also provide proper incentives for investment in rural America. In order to provide these incentives, the universal support mechanism should be transparent, stable, predictable, and competitively neutral as well as sufficient. To this end, the Recommendation is based on a consensus of diverse interests. This

[25] For more information on Rural Carrier service to Native Americans, *see* National Telephone Cooperative Association (NTCA) paper, *Dial Tone is Not Enough: Serving Tribal Lands*; NTCA, November 1999, and *NTCA Members Serving Tribal Areas Survey Report*, NTCA, December 10, 1999. *See* www.ntca.org.
[26] National Telecommunications and Information Administration, *Falling Through the Net: Defining the Digital Divide* (July 1999), page 36, Chart II-15.

should minimize controversy and legal challenges which create delay and uncertainty, and discourage investment. The Recommendation also attempts to provide sufficient support on an economically viable, administratively workable, and accountable basis. This should ensure that support is available to all carriers who accept the responsibilities of becoming ETCs, and that support is targeted to rural areas in a cost-effective manner.

The universal service mechanism recommended by the Task Force is a package of initiatives designed to provide both ILECs and CLECs with predictable and stable funding to motivate investment over the near-term future. The Task Force recognizes that the telecommunications industry is dynamic and changing rapidly. We believe it is unrealistic to expect any universal service mechanism to provide a stable, predictable and workable funding source for a period longer than five years. Consequently, we recommend that the Recommendation be implemented immediately and remain in place for a five year period. Plans should be made to evaluate appropriate universal service funding approaches for areas served by Rural Carriers prior to the end of this five year period.

III. METHODS AND POLICIES TO ESTABLISH PREDICTABLE AND SUFFICIENT SUPPORT FOR RURAL CARRIERS

Over the past two years the Task Force has undertaken a deliberative process to consider alternative methods and specific policies to establish predictable and sufficient financial support for Rural Carriers operating within high cost areas. In evaluating these alternative methods and policies, the Task Force gave careful consideration to all aspects of the 1996 Act, including the competitive provisions and universal service principles outlined in Section 254(b). Further, the Task Force gave significant weight to the administrative and economic viability of each alternative. As has been noted, a detailed record of the Task Force's proceedings are documented by the Task Force in a series of white papers and in meeting minutes available on the Task Force website.[27] Our purpose here is to highlight only briefly the key considerations and describe the specific recommendations agreed to by Task Force members.

A. Alternative Methods for Sizing the Fund –Overview of Options Considered

In its Mission Statement the Task Force made a commitment to explore alternative mechanisms for determining universal service support for Rural Carriers.[28] Throughout the course of its work, the Task Force considered a number of options for determining appropriate levels of universal service support for rural companies. In evaluating the different methods, the Task Force was guided by criteria developed early in the Task Force deliberations. These criteria are not simple restatements of the universal service principles.[29] They combine the universal service

[27] *See* www.wutc.wa.gov/rtf.
[28] *See Mission Statement, Objectives and Principles for Developing a Recommendation*, adopted by the Task Force December 12, 1998, available at www.wutc.wa.gov/rtf.
[29] Id.

principles with the tenets of technological and competitive neutrality, network evolvability, and economic and administrative viability.[30]

The Task Force criteria for an appropriate support mechanism for Rural Carriers may be summarized as follows:

1. **Sufficiency**: Does the mechanism ensure comparability of service and rates between urban or suburban customers and rural or insular customers?

2. **Affordability**: Does the mechanism enable providers to offer the supported services in an affordable manner?

3. **Competition**: Does the mechanism encourage and facilitate competition by precisely targeting support to high cost customers?

4. **Flexibility**: Is the mechanism able to evolve as new technologies are introduced, as competition develops, and as the definition of universal services changes over time?

5. **Protection and Advancement:** Does the mechanism prevent degradation of the existing infrastructure and the current level of service? Does the mechanism produce an investment incentive to upgrade facilities used to provide universal service?

6. **Portability**: Can the mechanism provide to all ETCs an appropriate amount of support in a competitively neutral manner?

7. **Predictability**: Does the mechanism enable a competitor or incumbent carrier to determine in advance the amount of support it will receive on behalf of a customer?

8. **Practicality**: Is the mechanism economically and administratively viable?

In reviewing the different alternative support mechanisms set forth below, the Task Force applied these criteria to each alternative. In developing its record, the Task Force considered several alternative methods to size the Rural Carrier fund including:

a) The Current Rural Support Mechanism (also referred to as the "Embedded Cost" Mechanism);

b) A Modified Embedded Cost Mechanism explicitly considering policy applications to address sufficiency and competitive concerns;

c) The FCC's mechanism for non-Rural Carriers using a forward-looking cost model;

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[30] See *Criteria to Determine if the Final Universal Service Support Mechanism for RTC's is Reasonable*, available at www.wutc.wa.gov/rtf.

d) Competitive bidding approaches;

e) Rate Buy-down Mechanisms, which allow rates to float to market level with an adjustment assuring customers pay no more than a targeted affordable level; and

f) A Melded Approach representing an attempt to blend the strengths of both the embedded cost mechanism and the Synthesis Model.

The strengths and weaknesses of each of these alternatives were identified and compared in White Paper 3, "Alternative Mechanisms for Sizing A Universal Service Fund for Rural Telephone Companies," published in August, 2000. Of the approaches evaluated, the Modified Embedded Cost Mechanism, with policy modifications to accommodate the sufficiency and competitive mandates of the 1996 Act, and the FCC non-rural method were considered to be the primary candidates for recommendation as the appropriate mechanism to size the universal service fund for Rural Carriers.

B. Evaluation of the Synthesis Model Applied to Rural Carriers

The Public Notice establishing the Rural Task Force directed the Task Force to give special consideration to the proxy cost models used for sizing and targeting universal service support to non-Rural Carriers.[31] The FCC, in fact, ultimately adopted a proxy cost model for use in sizing and targeting the non-rural fund in its Non-Rural Order.[32] The Task Force gave careful consideration to the model adopted by the FCC for non-Rural Carriers, and examined both the potential value and risks associated with applying the same model for determining forward-looking support for Rural Carriers and competitors serving customers in those areas. In conducting this analysis, the Task Force developed and adopted criteria in November 1999 for the evaluation of the proxy model tool for use with Rural Carriers. The criteria are detailed in White Paper 4 "A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies."

A detailed study was made of 23 sample companies. Also, a comparison of model results to actual company data for 195 additional companies was made. Attempts were made to study a diverse group of companies in terms of size, geography and regions of the nation. Application of the FCC Synthesis Model to the rural test companies produced the following results:

- The model lines differed significantly from actual lines served. While the model generally tended to underestimate lines, in about one-third of the wire centers it overestimated lines.

[31] "Federal-State Joint Board on Universal Service Announces the Creation of Rural Task Force; Solicits Nominations for Membership on the Rural Task Force." *Public Notice* FCC 97J-1, (rel. Sept. 17, 1997).

[32] *See* Non-Rural Order. These support calculations were revised on January 20, 2000, and April 7, 2000. *See*, "Common Carrier Bureau Announces Procedures for Releasing High-Cost Support Amounts for Non-Rural Carriers and Revised Model Results," FCC *Public Notice*, CC Docket No. 96-45, 97-160, DA 00-110 (Jan. 20, 2000) and In re: Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Twentieth Order on Reconsideration*, FCC 00-126 (April 7, 2000). Under these revised figures total annual funding for non-rural companies is estimated to be $220 million (exclusive of "hold harmless" support).

- Comparisons of the number of route-miles of plant summarized in the model with actual data produced significant variations. Again, differences occurred on both the high and low ends with a general tendency for the model results to overestimate the actual data. In 12 percent of the wire centers studied, the model overestimated route miles by more than 200 percent.

- Model results for the type of plant varied widely from actual plant constructed. The model generally tended to overestimate the percentage of aerial and underground plant, and underestimated the percentage of buried plant. This was likely due to the diverse character of the rural geography, and the use of a single set of inputs by density zone that was based on the experience of non-Rural Carriers.

- In calculating the applicable density zones, the model significantly underestimated wire center area. In 95 percent of wire centers the land area was understated, and in over one third of these the understatement exceeded 90 percent.

- The Synthesis Model significantly underestimated central office equipment (COE) Switching investment. This was likely due to the lack of economies of scale of the Rural Carriers, and the general tendency of the model to underestimate lines served.

- The Synthesis Model results for various elements of general support investment varied widely from actual data and from rational forward-looking assumptions, with almost as many cases of overestimation as underestimation.

- Network Operations and Customer Operations expenses were significantly underestimated. This was likely related to the lack of economies of scale of Rural Carriers.

The analysis also indicated that the model does not currently contain customer location and other data to produce results for rural wire centers in Alaska and the insular areas. The reasons for this are detailed in White Paper 4.

The aggregate results of this study suggest that, when viewed on an individual rural wire center or individual Rural Carrier basis, the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. As a result, it is the opinion of the Task Force that the current model is not an appropriate tool for determining the forward-looking cost of Rural Carriers.

In making this recommendation, the Task Force recognizes that policy makers, after the development and rigorous analysis of the Synthesis Model, have determined that it should be applied in developing universal service support for non-Rural Carriers. While the Task Force arrived at a different conclusion in regard to use of the model for Rural Carriers, we do not intend to imply in any way that revisions are needed to support mechanisms for non-Rural Carriers. Our analysis and recommendations are focused solely on Rural Carriers.

C. Tools versus Application

In considering both the potential value and risks associated with applying the FCC's Synthesis Model to estimate and target sufficient universal service support to Rural Carriers and competitors serving the same areas, it was obvious that the policies underlying the application of the proxy cost model tool were equally important, if not more important than the tool itself. An initial step in the Task Force's analysis was to directly apply both the Synthesis Model and the FCC's method for determining high-cost support for non-Rural Carriers. The results of that analysis are documented in White Paper 4.

We note here that applying the FCC's Synthesis Cost Model directly to the task of sizing the national Rural Carrier high cost fund and using the same policy mandates adopted for non-Rural Carriers would reduce available support to Rural Carriers from the current $1.553 billion to $451 million, a reduction of over one billion dollars. A primary reason for that reduction was the FCC's decision to rely on a nationwide benchmark and statewide cost-averaging to determine a "sufficient" level of federal funding for non-Rural Carriers. Because Rural Carriers represent only a fraction of the overall industry, their addition in determining the national average cost benchmark changes the average by only a small amount,[33] even though as a group the average total cost of service for Rural Carriers is more than twice that of non-Rural Carriers.[34] For the same reason, averaging the cost of Rural Carriers with the costs of all other carriers within a state would eliminate funding for many Rural Carriers. Thirty-seven states, territories, and protectorates which receive federal universal service support for Rural Carriers today would receive zero support if statewide cost-averaging and a national benchmark were used in sizing the universal service fund available to Rural Carriers.[35]

The Task Force recognizes that policymakers would not likely adopt a statewide cost-averaging and a national benchmark for application to the Rural Carrier mechanism with this knowledge available to them. We further recognize that alternative benchmarks are easily considered. However, the exercise of applying the non-Rural Carrier policies directly in considering use of the Synthesis Model for sizing the Rural Carrier fund was helpful to Task Force members, highlighting the importance of specific policy choices in designing an appropriate support mechanism tool and policy.

This line of inquiry and the record assembled to support the inquiry is instrumental to the Task Force's recommendation of the method to size the fund necessary to provide sufficient support to Rural Carriers and competitors providing service in those areas. Weaknesses associated with both the Synthesis Cost Model and embedded cost approaches can potentially be mitigated by appropriate policy choices. Consequently, the choice of method to size and target the fund may

[33] The estimated nationwide average cost per line increases from $23.52 per line for non-Rural Carriers to $26.09 per line for non-Rural Carriers and Rural Carriers combined.
[34] The estimated average cost per line for Rural Carriers is $59.36 per line compared to an estimated $23.52 per line for non-Rural Carriers. It should be noted that based on subsequent input changes for the Synthesis Model, the current estimated nationwide average cost per line for non-Rural Carriers has changed to $23.35 per line.
[35] *See* Appendix D of White Paper 4.

appropriately rest at least in part on practical considerations; such as administrative simplicity and ease of minimizing unintended consequences.[36]

D. Recommended Method for Sizing the Fund

For the reasons detailed in White Paper 4, we conclude that the non-rural method and Synthesis Model developed for the non-Rural Carriers are not the appropriate tool and application for Rural Carriers and will not produce a sufficient universal service mechanism for Rural Carriers that is in the public interest and consistent with the principles of the 1996 Act. The Task Force Recommendation relies on the Modified Embedded Cost Mechanism for Rural Carriers as a baseline to size the fund for Rural Carriers. This method is based on embedded costs of each ILEC's study area. In other words, support is based on the investments and expenses of each study area.

There are three forms of support currently flowing to Rural Carriers:

1. The High Cost Loop[37] (HCL) fund helps offset the cost of loop facilities used to provide local service. When a study area's average loop cost exceeds 115 percent of the national average loop cost, that study area receives a portion of its costs above 115 percent from the fund. The amount of support increases in specified steps as the percentage of cost that exceed the national average rises.

2. Long-Term Support[38] (LTS) helps offset the cost of interstate access for Rural Carriers remaining in the National Exchange Carrier Pool (NECA) pool.

3. Local Switching Support[39] (LSS) provides support for the high per-line local switch equipment costs incurred by carriers with less than 50,000 loops.

These three funds currently provide approximately $1.553 billion in annual support to the over 1,300 Rural Carrier study areas in the United States and its territories. Each form of support is determined by averaging costs over the company's entire study area. (LTS is averaged over all companies participating in the NECA common line pool.) Per line support is determined by dividing total support by the total number of lines within a study area.

The total amount of the HCL available for Rural Carriers is currently capped. Under the cap, overall high cost support grows at the same rate as the growth in the number of access lines, including the lines of non-Rural Carriers. It is estimated that without the cap, the High Cost Fund

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[36] The Task Force did not compute the impact on Rural Carriers of using the current Rural Carrier benchmarks and policies with the Synthesis Model. This was not done for several reasons in addition to the fact that the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking costs. These reasons included the perceived administrative complexity of adapting the Part 36 Rules for calculating the High Cost Loop fund and Local Switching Support to the Synthesis Model, and the anticipated significant increase in high cost support that would result from such an analysis, which would be applied on a study area basis.

[37] *See* 47 C.F.R. Section 36.631.

[38] *See* 47 C.F.R. Section 54.303.

[39] *See* 47 C.F.R. Section 54.301.

for Rural Carriers would be approximately $83.9 million higher.[40] The Task Force studied the characteristics and operation of the current support system as a benchmark for comparison of all other support mechanisms.

In recommending the Modified Embedded Cost Mechanism for federal universal service support for Rural Carriers, the Task Force recognized some of the weaknesses of the current system and included modifications to address these weaknesses and to adapt the mechanism to the current environment. Modifications are necessary to ensure support is sufficient to achieve the universal service principles contained in Section 254 of the 1996 Act. Universal service funding is not a static need, but rather must be dynamic, adjusting to provide support available in sufficient amounts to ensure the mandates of the 1996 Act are achieved in rural areas as technology advances. Specific recommendations for modification to the current method of federal universal service support are made in Section IV of the Recommendation.

Modifications necessary to make the current rural funding mechanism consistent with the competitive provisions of the 1996 Act and the principle of competitive neutrality are equally important. In recommending the use of the Modified Embedded Cost Mechanism to implement federal universal service support for Rural Carriers, the Task Force urges the FCC to also adopt specific actions to ensure ILECs and CLECs have access to available funding on an equivalent basis. Specific recommendations are made in Section V of this Recommendation.

Finally, in recommending the Modified Embedded Cost Mechanism for Rural Carriers, the Task Force represents to the Joint Board and the FCC that we have carefully considered available checks and balances within the system to ensure universal service dollars are spent for the purposes they are intended by the 1996 Act as discussed hereafter. Specific recommendations are made in Section IV (D) below.

IV. POLICY CHOICES AFFECTING REQUIRED FUND SIZE

In recommending the Modified Embedded Cost Mechanism of universal service support for Rural Carriers, the Task Force recognizes certain changes are necessary to ensure funding available to both CLECs and ILECs is sufficient to achieve the universal service mandates of the 1996 Act and is available to all ETCs on an equitable and competitively neutral basis. Below we highlight specific recommendations necessary to provide sufficient support.

[40] In addition to the cap on the growth of the HCL fund, there is a limitation on recovery of corporate operations expense and caps on universal service funds related to newly acquired exchanges. It is estimated that removal of the corporate operations expense limitation would increase the fund for rural carriers by $34.6 million, and that removal of the cap on acquired exchanges would increase the fund by $12.8 million. *Universal Service Fund 1999 Submission*, NECA (Oct. 1, 1999).

A. Recommendations Requiring Sufficient Funding to Achieve Advanced Telecommunications Service Access and Comparability Provisions of Section 254

The 1996 Act delineates the requirements related to advanced services in Sections 254 and 706. Working from these statutory mandates and cognizant that recent studies indicate that advanced services and broadband infrastructure have been deployed much more extensively in the more urbanized areas of the United States, the Task Force has examined the issue of providing access to advanced services.[41] The provision of access to advanced services is required under Section 254(b) and is separate and distinct from the actual provision of advanced services when and if they have been added to the supported services defined periodically by the FCC under Section 254(c).

1. Advanced Services

Under the 1996 Act, universal service is an evolving level of telecommunications services that the FCC shall establish periodically, taking into account advances in telecommunications and information technologies and services. Because of advances in telecommunications services, the Task Force recommends that the Joint Board review the definition of the services that are supported by federal universal service support mechanisms.

In recommending that support for Rural Carriers be based on embedded costs, the Task Force is recommending a support mechanism that inherently provides incentives for the infrastructure investments necessary for providing access to advanced services. Just as the FCC "removed barriers from infrastructure investment" in its implementation of the Synthesis Model, policies should be adopted that remove barriers from infrastructure investment for the rural ETCs, and encourage the provision of comparable and comparably-priced access to advanced services.

The Task Force also recommends that a "no barriers to advanced services" policy be adopted that incorporates the following principles:

a. Universal service funding should support plant that can, either as built or with the addition of plant elements, when available, provide access to advanced services. State commissions could facilitate this infrastructure evolution and may make an exception for carriers with functional but non-complying facilities.[42]

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[41] An April 2000 report by the National Telecommunications and Information Administration and Rural Utilities Service found that digital subscriber line (DSL) and cable modem deployment in large cities surpassed that in small towns by more than a factor of ten. *See Advanced Telecommunications in Rural America: The Challenge of Bringing Broadband Service to All Americans*, at page ii. In August 2000, the FCC identified, among others, "those living in sparsely populated areas . . . and . . . in the U.S. territories" as "particularly vulnerable to not having access to advanced services." *Deployment of Advanced Telecommunications Capability*: Second Report, page 6.

[42] Not all ETCs can provide access to advanced services over existing infrastructure, and the Task Force recommends that an ETC should not lose universal service support, or be denied ETC designation because it cannot provide access to advanced services, as currently defined, if it otherwise provides all of the supported services.

b. Telecommunications carriers should be encouraged by regulatory measures to remove infrastructure barriers relating to access to advanced services.

c. The federal universal service support fund should be sized so that it presents no barriers to investment in plant needed to provide access to advanced services. Specifically, to remain "sufficient" under the 1996 Act, the fund should be sized so that investment in rural infrastructure will be permitted to grow.[43]

2. Information Services

In addition to requiring access to advanced services, Sections 254(b)(2) and (3) require access to information services that is reasonably comparable to that provided in urban areas. This access is separate and distinct from access to advanced services. Information services can be accessed over voice grade circuits to Internet service providers. For this access to be comparable to urban areas, it should be at a bit rate equal to that received by urban customers. About two-thirds of urban customers are in areas served by plant capable of receiving this service at a rate of at least 28.8 kilobits per second.[44]

While this service is different from access to advanced services, there is an important relationship between the plant architectures that provide the two services. The "no barriers to advanced services" plant architecture recommended above supports 28.8 kilobits per second modem access. Investments made to comply with the 1996 Act's requirements to provide access to advanced services would thus serve a double function.

The Task Force recommends that the list of supported services should evolve to include access to information services at a rate that is reasonably comparable to that provided in urban areas. Plant that will provide access to advanced services will also provide access to information services at this rate.

B. Recommendations Providing for Fund Growth Necessary to Achieve Section 254 Mandates – Caps and Limitations to the Existing HCL

Current FCC rules limit the availability of HCL assistance to carriers in three ways:

1. Growth in total HCL funds available is limited to the prior year's level of payments increased by the growth in lines subject to Section 36.601(c) universal service rules;

2. Corporate operations expenses assigned to the HCL fund calculation is limited; and

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[43] *See* 47 U.S.C. 254(b)(4).

[44] *See* Comments of the Rural Utilities Service, In The Matter of Requests to Redefine "Voice Grade Access" For Purposes of Federal Universal Service Support, January 19, 2000, CC Docket No. 96-45, www.usda.gov/rus/unisrv/01-19com.htm.

3. Individual study area expense adjustment limitations are imposed by the FCC when granting some study area waivers for some entities involved in the purchase or acquisition of exchanges[45] and Section 54.305 of the FCC rules which limits the universal service support for an acquiring company to the support received by the selling company.

In order to provide appropriate incentives to invest in rural America while maintaining the fund at a reasonable level, the Task Force recommends that the Joint Board and FCC enact the following modifications to the caps and limitations which currently exist related to the universal service support mechanisms for Rural Carriers.

1. Indexed Cap On High Cost Loop Support

In general the Task Force recommends that the HCL fund be re-based and a new cap factor be applied on a going-forward basis. In addition, a new procedure should be established to determine per-line support when a competitive ETC (CETC) begins providing service in a Rural Carrier service area. Finally, a new HCL fund "safety net" calculation is proposed to provide additional support to Rural Carriers who make a significant investment in rural infrastructure. In particular, the Task Force recommends:

a. Re-basing the Cap

i) The existing indexed cap on the HCL fund should be removed and the portion of the HCL fund for Rural Carriers should be separated from the non-Rural Carriers' portion of the fund.

A) The rural portion should initially be recomputed by the fund administrator at the level required for Rural Carriers as if the indexed fund cap and the corporate limitation had not been in effect for support for the calendar year 2000 (i.e., based on 1998 calendar year data using the October 1, 1999 data submission).[46]

B) For 2001 and future years, the Rural Carrier fund should be calculated using the existing methods as modified by the recommendations outlined below.

ii) The national average loop cost should be frozen at $240.00, which approximates the actual average for year 2000 support (i.e., based on 1998 data).

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[45] On August 4, 2000, the FCC adopted an Order removing the interim caps for all carriers who had previously had limitations placed on their universal service support as a result of purchase or acquisition of property from another local exchange carrier. Petitions for Waiver Concerning Definition of "Study Area," CC Docket No. 96-45, *Order* (rel. Aug.4, 2000).

[46] This re-basing should result in an increase to the HCL fund of approximately $118.5 million consisting of $83.9 million for the indexed fund cap and $34.6 million for the corporate operations expense limitation based on October 1, 1999 data and calculations supplied by NECA to the Task Force.

iii) The total individual company study area support should continue to be calculated based on the ILEC's costs and loops under the current "expense adjustment" formulas with the modification to corporate operation expenses discussed below.

b. New Indexed HCL Fund Cap

i) A new indexed cap on the ILECs' portion of the HCL fund should be imposed with annual maximum growth derived by the "Rural Growth Factor" (RGF).

A) The RGF is the sum of the annual percentage change in Gross Domestic Product-Chained Price Index[47] plus the percentage change in loop count for Rural Carriers, using a consistent definition of Rural Carrier study areas in the numerator and denominator of the equation calculating the change in loop counts. The RGF should be computed annually by the federal universal service fund administrator to determine the succeeding year HCL fund cap level for Rural Carriers.

B) The maximum support under the indexed HCL fund cap for 2001 for the ILECs' portion of the HCL fund should be the year 2000 HCL amount described in Subsection IV(B)(1)(a)(i)(A) times one plus the RGF.

C) For each of the succeeding years, the cap should be computed by taking the total loop cost expense adjustment for the immediately preceding calendar year, times one plus the RGF.

D) In any year when the cap is reached, the "safety net" provisions described in Subsection IV (B)(2)(e) below should be computed and implemented by the federal universal service fund administrator.

ii) Current procedures will remain in place excluding the HCL fund support paid to CETCs from the indexed cap calculation.

c. Support in Areas with CETCs

i) In areas served by Rural Carriers where a CETC has not submitted revenue producing lines to the federal universal service administrator in order to receive support, per line support available to the CETC would be determined pursuant to the disaggregation paths set forth V(A). However, support paid to the ILEC would be based on Subsection IV(B)(1)(a)(iii) of the Recommendation.[48]

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[47] This is the same factor used for the LTS calculation.

[48] For transparency purposes, the ILEC's disaggregation plan would disaggregate the study area support on a per line basis as set forth in Section V(B)(2). It should be noted that in areas served by Rural Carriers where a CETC has not submitted revenue producing lines to the federal universal service administrator, the ILEC would receive monthly universal service support payments based on the annual USF support (i.e., HCL, LTS and LSS) divided by 12.

ii) In study areas where a CETC has been approved and the CETC is providing service, universal service support payments per loop to the ILEC and CETC serving the same area should be the same and should be determined by freezing the ILEC support per loop.

A) The disaggregated support per loop should be frozen based on the data for the twelve month period ending with the end of the quarter prior to the quarter in which the CETC first reports revenue-producing lines to the federal universal service administrator to receive support.[49] In no event will the ILEC's HCL fund support exceed the amount the ILEC would receive under the method set forth in Subsection IV(B)(1)(b)(i).

B) Both the ILEC and the CETC's support should be adjusted quarterly for actual revenue-producing lines in service.

C) The support per loop would be increased annually by the RGF used to grow the indexed cap for the fund.

D) In a year when the overall indexed HCL fund cap is invoked, the ILEC HCL payments for the study area will be the lesser of the amount calculated in sections IV(B)(1)(c)(ii)(A) through IV(B)(1)(c)(ii)(C) above or the "expense adjustment" calculated pursuant to normal rules under the new cap mechanism described in Subsection IV(B)(1)(b) above.

E) Notwithstanding the above limitation on per line support, an ILEC may adjust frozen per loop support to recover costs of catastrophic events affecting the ability of ETCs to provide universal service.[50] Such catastrophic events shall include hurricanes, floods, earthquakes, fires or other natural disasters evidenced by a declaration of natural disaster by state or federal authorities and which directly affect the ability of ETCs to deliver universal service.

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[49] The ILEC would be required to update their universal service fund data for the twelve months ended the quarter prior to the CETC submitting loops to the federal universal service fund administrator. The universal service fund data submissions would include the ILEC updating all of the investments, expenses and loop data. The frozen support per line would be computed by taking the ILEC's support divided by the lines at the end of the twelve month reporting period.

Month CETC submits lines to the Administrator	ILEC submits updated data for the 12 months ending:
January, February, March	December 31
April, May, June	March 31
July, August, September	June 30
October, November, December	September 30

For example, if a CETC submits lines in June 2001 to the federal universal service fund administrator, the ILEC would be required to update the ILEC's universal service fund data submission for the 12 months ending March 31, 2001. The frozen support per line would be computed by taking the ILEC's support for the 12 months ending March 31, 2001 divided by the lines as of March 31, 2001. These amounts would be disaggregated pursuant to other provisions in the Task Force's Recommendation.

[50] The term "costs" as used herein is intended to include both expenses and investment.

F) Under any circumstances set forth above, ILECs and CETCs serving the same area would receive the same amount of support per loop.[51]

d. New Supported Services

The indexed cap should be resized whenever the definition of supported services is changed.

e. Safety Net

In a year where the new indexed cap on the HCL fund limits the study area's expense adjustment, the federal universal service fund administrator will determine if any study areas qualify for the following "safety net." The "safety net" would never allow the study area to receive more with the safety net than the study area's HCL fund support (i.e., the study area expense adjustment) would have been if the indexed cap had not taken effect for the year. The "safety net" computation would be as follows:

i) The "safety net additive" will be calculated for each study area where the growth in telecommunications plant in service (TPIS) per line is 14 percent[52] greater than the study area TPIS per line in the prior year.

ii) The "safety net additive" will be equal to 50 percent of the difference between the capped "expense adjustment" for the study area and the uncapped amount for the study area.

iii) The "safety net additive" will be paid in addition to the "expense adjustment" calculated for the study area.

iv) "Safety net additives" for all eligible study areas will be paid over and above the indexed HCL fund cap amount.

v) Any study area that qualifies for the "safety net additive" will also qualify for a "safety net additive" in each of the four succeeding years regardless of whether it meets the 14 percent criterion in those years.

2. Corporate Operations Expense Limitation

The corporate operations expense limitation imposed in the FCC's rules limits the amount of the corporate operations expense that is assigned to the HCL fund "expense adjustment"

[51] It should be noted that the Task Force could not reach agreement on the "stranded cost" issue. *See* Subsection V(B)(6) of this Recommendation. *See also* White Paper 5 for more discussion on this subject.
[52] The 14 percent factor was chosen as an estimate of twice the average RGF in recent years.

calculation for certain study areas.[53] The Task Force proposes modifying the existing formula by re-basing and indexing the dollar values in the "expense adjustment" calculation and by adding an alternative calculation for determining the maximum amount of corporate operations expense assigned to the "expense adjustment" calculation.

a. The corporate operations expenses assigned to the HCL fund calculation for each study area would be the lower of the actual corporate operations expenses for the study period or the calculated amount of corporate operations expenses under Subsection IV(B)(2)(b) below.

b. The calculated amount of corporate operations expense would be the higher of the amounts calculated under Subsections IV(B)(2)(b)(i) or IV(B)(2)(b)(ii) below.

i) The corporate operations expense assignment to the HCL fund calculation under this alternative would be based on modifying the existing Section 36.621(a)(4) formula.[54]

A) The dollar values in this formula would be grown annually by the RGF to reflect increased costs since the formula was put into place due to increased work requirements, labor, and other costs.[55]

B) Upon implementation of this Recommendation the dollar values in this formula would be grown by the RGF for each year since the formula was adopted. In each subsequent year the dollar values would be grown by the RGF for the subsequent year.

ii) The corporate operations expense assignment to the HCL fund calculation under this alternative would be based on the following calculation:

A) The year 2000 uncapped corporate operations expense per line (i.e., using 1998 data) will be calculated for each study area. The corporate operations expense per line will be multiplied by the number of lines to yield the corporate operations expense.

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[53] Based on information provided by NECA, 205 rural study areas were affected in 2000 based on 1998 data. The number of Rural Carriers impacted by this limitation has increased by 15 percent in the two years since this limitation was imposed.

[54] Part 36.621(a)(4) states: "Total Corporate Operations Expense, for purposes of calculating universal service support payments beginning January 1, 1998, shall be limited to the lesser of: (i) the actual average monthly per-line Corporate Operations Expense; or (ii) a per-line amount computed according to paragraphs (a)(4)(ii)(A), (a)(4)(ii)(B), and (a)(4)(ii)(C) of this section. To the extent that some carriers' corporate operations expenses are disallowed pursuant to these limitations, the national average unseparated cost per loop shall be adjusted accordingly. (A) For study areas with 6,000 or fewer working loops the amount per working loop shall be $31.188 - (.0023 x the number of working loops), or, $25,000 divided by the number of working loops, whichever is greater; (B) For study areas with more than 6,000 but fewer than 18,006 working loops, the amount per working loop shall be 3.588 + (82,827.60 divided by the number of working loops); and (C) for study areas with 18,006 or more working loops, the amount per working loop shall be $8.188."

[55] An analysis of this alternative indicates that if the FCC included a modest annual growth of five percent in the dollar amounts associated with this alternative, the number of Rural Carriers experiencing a limitation on their corporate operations expenses would have actually declined rather than growing by 15 percent over the past two years, and the shortfall amount would have been $15.1 million less than 1/2 of its current level ($34.6 million based on data provided by NECA at the request of the Task Force).

B) For 2001 and each subsequent year, the study area corporate operations expense amount per line will be grown by multiplying the previous year's amount per line times one plus the RGF. The corporate operations expense amount per line will be multiplied by loops at the end of the study period to arrive at the calculated corporate operations expense.

The purpose for the additional alternative proposed is to provide an option other than the waiver process for companies which have corporate operations expenses above the Section 36.621(a)(4) limitation. Some companies consistently have corporate expenses which are higher than this formula would allow. While the waiver process is an option to obtain relief, it is very expensive for a small Rural Carrier like Interior Telephone in Alaska, and has yielded petitioners only a one-year waiver.[56]

The Task Force acknowledges that the waiver process can be economically infeasible for some rural carriers. Therefore, in order to provide a cost-efficient alternative to the waiver process the Task Force has proposed the alternative calculation described above.

3. Merger and Acquisition Cap

Section 54.305 of the FCC's rules state "A carrier that acquires telephone exchanges from an unaffiliated carrier shall receive universal service support for the acquired exchanges at the same per-line support levels for which those exchanges were eligible prior to the transfer of the exchanges." The Task Force has concerns that in many cases, this Section limits the ability and motivation of the acquiring entity to make new investments to upgrade the networks in these acquired properties in spite of their high cost and rural nature. The Task Force agreed that the following principles should be applied in considering universal service support for acquired or transferred exchanges:

a. Customers in high cost rural exchanges involved in sale/transfer transactions should not be "doomed" to poor service because they live in exchanges that have been involved in sale/transfer transactions where the previous owner had limited access to universal service support funds.

b. A mere transfer of ownership should not result in an increase in support associated with the acquired lines. At the same time, universal service support should provide incentives for new investment in rural America.

c. The universal service support system should not artificially inflate the price on sale/transfer transactions.

[56] For example, the FCC granted Artic Slope Telephone Association Cooperative, Inc. a limited one-year waiver of the corporate operation expense recognizing that costs incurred to provide telephone service in Alaska are higher than in the lower 48 states and that it was in the public interest of maintaining affordable rates. Order DA 98-2586 (rel. Dec. 22, 1998).

d. Where meaningful new investments are made a universal service support "safety valve" mechanism should provide some support to high cost rural exchanges involved in sale/transfer transactions. Any additional universal service support should be driven by post-transaction investments made to enhance the infrastructure of and improve the service in these exchanges.

e. Any transferred universal service support under current rules or additional support under this "safety valve mechanism" is over and above the indexed HCL fund cap.

f. The "safety valve mechanism" should be capped at some appropriate level.

The Task Force recommends that the FCC establish an appropriate "safety valve mechanism" for Rural Carriers which acquire access lines due to sale or merger. Under this mechanism Rural Carriers would receive, over a period of five years, support for new investments that enhance the infrastructure in rural exchanges. An illustration of the specifics of a "safety valve" mechanism is attached as Appendix D.

C. Principles for Preserving any Current Universal Service Support Which May be Implicit Within Interstate Access Charges – The Underlying Basis for High Cost Fund III (HCF III)

The Task Force recognizes that interstate access may also include high cost universal service support in the form of implicit support. The Task Force accordingly identified the potential need for an additional universal support fund, High Cost Fund III, to replace support implicit within current interstate access charges collected by Rural Carriers.

High Cost Fund III is needed, in part, to respond to a disparity of access rates between Rural Carriers and non-Rural Carriers. Disparity of access rates between Rural Carriers and non-Rural Carriers results from at least two different phenomena: cost differences between these companies and differences in implicit support inherent in their current access rates.

Cost differences in the provision of service between Rural Carriers and non-Rural Carriers result from a host of factors including customer density, distance, average switch size, average trunk usage, and company size as shown in Task Force White Paper 2. These cost differences are real and discernable under whatever cost measurement is employed.

Rate disparity between the Rural Carriers and non-Rural Carriers related to the current level of implicit support inherent in access rates arise from a number of prior public policy decisions. Key among these decisions are policies to average rates across broad areas (the study area) and to recover basically fixed costs of operations through usage-sensitive rates, and costs which may be considerably higher in areas served by Rural Carriers because of the higher cost of operations in those areas. The implicit support that comes from the broad averaging of costs across high cost and low cost areas or the above-cost pricing of certain market segments may be incompatible with a competitive environment.

The continuing development of interstate toll competition and the access reform policies

implemented for price-cap companies have the potential to increase the rate disparity between interstate access rates of price-cap (primarily non-Rural Carrier) and rate-of-return (primarily Rural Carrier) local exchange companies. These disparities potentially can cause significant pressures on interexchange carriers to geographically deaverage toll rates. In light of the conflict between these pressures and the requirements of Section 254(g) to maintain geographically averaged toll rates, some industry participants propose expansion of the role of the federal universal service fund to address some of the concerns related to interstate access rate differentials between large and small local exchange carriers.

The Task Force discussed the issue of implicit support in access rates in relationship to its role to provide recommendations regarding the federal universal service fund for Rural Carriers. The Task Force recommends the following principles:

1. Current interstate access charges of Rural Carriers may contain some amount of implicit interstate universal service support, although there is no agreement on how much or how to determine the amount of implicit support.

2. When the FCC addresses interstate access charges for Rural Carriers, it should identify the appropriate unit prices of interstate access. The Task Force is not recommending any particular method for arriving at appropriate interstate access prices.

3. The difference between current interstate access revenues and the repriced interstate revenues should be replaced by an un-capped High Cost Fund III. These payments from High Cost Fund III should be distributed on a per line basis.

4. HCF III should be funded by equitable and nondiscriminatory assessments on all interstate telecommunications carriers.

5. HCF III support may be geographically deaveraged by cost zone and targeted to high cost areas served by Rural Carriers.

6. HCF III support should be portable and should be available to all eligible telecommunications carriers on an equitable, non-discriminatory, and competitively neutral basis.

7. Once determined, HCF III should be adjusted annually, based on the annual interstate access filings of the Rural Carriers that are rate-of-return regulated. These annual adjustments to HCF III would continue until these carriers are no longer rate-of-return regulated, save for any low-end-type adjustment.[57] Rate-of-return carriers that shift to incentive regulation should have a comparable hold harmless adjustment, but the Task Force takes no position at this time on the nature of that mechanism.

8. Compliance should be economically and administratively workable.

[57] *See* 47 CFR 61.45(d)(1)(viii).

9. Consumers should receive benefits from HCF III in the form of lower rates and/or greater choice.

D. Accountability

During the Task Force's review, NECA presented information regarding the existing system of checks and balances applicable to rural carriers.[58] Currently NECA collects unseparated cost data from prospective high cost support recipients on an annual basis, and reviews the data for reasonableness. NECA then recommends the level of support to the Universal Service Administrative Company (USAC), and ultimately to the FCC.

For the past several years, NECA has utilized a mechanized data collection process that allows ILECs or their authorized consultants to enter and review data for consistency. This system uses an extensive set of edit and range controls to check data for reasonableness by automatically comparing new data to prior year data. Each system user is alerted to significant variations through automated reporting that identifies unusual data and requires explanations, which NECA reviews for compliance purposes. Where necessary, additional supporting material is obtained from the carrier.

ILECs submit data to NECA on or before July 31st each year. The ILECs include with their data submission signed letters of certification attesting to the accuracy of their data.[59] NECA reviews this data for accuracy and conformance with FCC rules. As part of its data integrity review process, NECA reconciles the data to financial records underlying the ILECs' cost studies. Prior to the submission of the data, NECA performs a reconciliation of the largest ILECs' data to audited company financials. When errors are detected, corrections are made to the data and expense adjustments are then recomputed.

NECA requires ILECs to provide explanations or corroborating information to substantiate questionable data and or significant increases/decreases from the prior year amounts. NECA staff reviews ILEC responses for reasonableness and where necessary contacts the ILEC to correct discrepancies. In addition to the internal review performed by NECA, each year a group of industry experts review the results of the annual submission prior to its being filed with the FCC and USAC.

If there is a disagreement between the applying carrier and NECA concerning a data submission, there is an attempt to settle the conflict at that level. If this fails, the FCC is brought in to settle the dispute. Concurrently, state commissions (intrastate) and the FCC (interstate) have the

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[58] *See* NECA, Presentation before the Task Force, July 20-21, 2000, Seattle, Washington, available at www.wutc.wa.gov/rtf.

[59] Section 69.601 of the Commission's rules, 47 C.F.R. 69.601, requires that all data submissions made to NECA must be accompanied by a certification statement signed by the officer or employee responsible for overall preparation of the data submission. *See* 47 C.F.R. 69.601 (c) and Safeguards to Improve the Administration of the Interstate Access Tariff and Revenue Distribution Processes, CC Docket No. 93-6, RM 7736, and Consideration of NECA's Incentive Compensation Plan, AAD 95-34, Report and Order and Order to Show Cause, 10 FCC Rcd 6243, 6264 (1995). NECA has required certification for all universal service fund data reports since 1990.

legal jurisdiction to directly determine the regulatory reasonableness of expenditures for many of the participating carriers.

Based on its limited review of existing procedures, the Task Force believes that the process currently used by NECA, USAC, the FCC, and state commissions reasonably promotes accountability. Such assurances are, of course, critical. Failure to achieve accountability could result in excessive costs and unjustified benefits, leading to an artificially large fund. Coupled with the Task Force's reasoned recommendations concerning the cap on funding, these accountability measures should assure regulators that the new support system will operate in the public interest.

The Task Force reiterates that, under Section 254(e), a carrier receiving such support shall use that support only for the provision, maintenance, and upgrading of facilities and services for which the support is intended. The Task Force recommends that states be delegated responsibility for oversight of this section in a manner similar to that used for the non-rural LECs (i.e., annual certifications).[60]

Consumers are and should be the ultimate beneficiary of the 1996 Act. Section 254 (b)(1) requires "just, reasonable, and affordable rates" and 254(b)(3) requires "reasonably comparable" rates and services in all regions of the nation. In White Paper 2, the Task Force observed that prior to the enactment of the 1996 Act, that on average the combined monthly bills for local and long distance service for customers of Rural Carriers and non-Rural Carriers were within pennies of each other. The Task Force also noted in that paper that telephone penetration rates were 94.9 percent for non-Rural Carriers and 92.5 percent for Rural Carriers.

As competitive and universal service reforms are implemented, the Task Force urges state and federal policy makers carefully monitor the affordability of rates and the ubiquity of the modern telecommunications services to ensure that the benefits of the law are realized.

V. REFORMS TO ACHIEVE COMPETITIVE PROVISIONS OF THE 1996 ACT

The Task Force recognizes the current method of Rural Carrier support must also be modified to be consistent with the competitive provisions of the 1996 Act and the principle of competitive neutrality. To this end the Task Force recommends that support be disaggregated, and that transparent, portable per line support be established for each Rural Carrier. Below are specific recommended modifications to the current mechanism.

A. Disaggregation and Targeting of Support

In White Paper 6 "Disaggregation and Targeting of Universal Service Support," the Task Force discussed the need and options for targeting universal service support. It does not appear that an adequate "one size fits all" approach is workable for disaggregation. As set forth in White Paper

[60] *See* Non-Rural Order at Paragraph 93. *See also* 47 CFR, Part 54.3.

2, Rural Carriers are not only different from non-Rural Carriers but the population of Rural Carriers contains disparate characteristics and operating environments. The need to target funds and the method used for disaggregation also needs to meet the unique regulatory and competitive environments in each state. Notably, states have the authority to designate ETC status,[61] suggest changes in service areas for ETC status to a Joint-Board and the FCC,[62] and establish many of the other rules and parameters for local competition.[63] Additionally, some states have already acted on a variety of ETC and disaggregation issues, and the Task Force does not wish to disrupt any tailored situations that are already in place.

The Task Force recommends a system that allows for adequate flexibility to take into account the unique needs of companies with widely varying geographic cost characteristics and the competitive and regulatory environment in each state. The Task Force also recognizes the need for safeguards to prevent gaming the system.

The Task Force recommends that the mechanics of the disaggregation system be based on the following general requirements.

1) The ILEC's study area support available in total for a study area from the disaggregated method(s) would equal the total support available without disaggregation.

2) The relative per line support relationships[64] between disaggregation zones for each disaggregated category of support would remain fixed over time (except as changes are allowed by the Path descriptions). These relationships would be publicly available as described in Section V (B)(2).

3) Until a CETC is certified in a study area, monthly payments to ILECs will be made using current procedures based on total annual amounts for a study area divided by 12.

4) When a CETC is certified for a study area, per line amounts to determine the CETC's disaggregated support would be based on the ILEC's then current total support levels, lines, and disaggregated support relationships.

    a) Support per line for each category of support for each disaggregation zone would be determined such that the relative support relationships between zones would be maintained and that the product of all of the ILEC's lines for each cost zone times the per line support for those zones would sum to the total ILEC support.

    b) Per line support amounts for each zone would be recalculated whenever the ILEC's total annual support amount changed using the changed support amounts and lines at that point in time.

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[61] *See* 47 U.S.C. 214(e)(2).
[62] *See* 47 U.S.C. 214(e)(5).
[63] *See* e.g. 47 U.S.C. 251(f) and 47 U.S.C. 252.
[64] These relationships may be most easily understood by expressing them in support per line per month format.

The Task Force recommends establishing a targeting system that allows Rural Carriers to use different paths based on the circumstances and needs encountered by each carrier. The Task Force recommends all of the following individual paths be established to meet these goals:

Path 1: For Rural Carriers that do <u>not</u> want to target high cost support

A) Within 270 days from the effective date of the final rules, Rural Carrier certifies to the state commission, or other appropriate regulatory authority, that it does not want to disaggregate high cost support.[65]

B) The plan becomes effective upon filing with certification.

C) Certification lasts for at least four years[66] from the effective date, unless during that time the state commission or other appropriate regulatory authority requires, on its own motion or upon petition by an interested party, the disaggregation of support, grants ETC status below the study area level, state or federal laws or regulations change, or if a change in ownership occurs. At that time, the Rural Carrier may target support through the use of either Path 2 or Path 3.

Path 2: For Rural Carriers that want review and approval for targeting high cost support

A) Within 270 days from the effective date of the final rules, the Rural Carrier files a disaggregation plan with the state commission or other appropriate regulatory authority.

B) There are no constraints on Rural Carrier proposals under this path.

C) Regulatory authority holds workshops, hearings or other appropriate administrative proceeding in which interested parties may participate. Any such proceedings should be economically and administratively workable.

D) Regulatory authority issues an order on targeting support, including a description of the zones, and a per line amount of support for each element in each zone.

E) The plan is effective until the regulatory authority approves a new plan. The targeting plan is subject to change or challenge at any time.

[65] Throughout this discussion the Task Force recognizes that some state commissions may lack the authority to implement the Recommendation with regard to targeting of high cost support, in which case we assume the appropriate regulatory authority will govern.

[66] With the 270 day period prior to filing, plus the four year effective period, the total period elapsed is nearly the five years prescribed for these recommendations.

Path 3: For Rural Carriers that want to self-certify a method for geographic disaggregation

A) Within 270 days from the effective date of the final rules, Rural Carrier files a disaggregation plan with the state commission or other appropriate regulatory authority along with a statement certifying each of the following:

1. Plan disaggregates support to the wire center level. Carriers may choose to further disaggregate support into no more than two cost zones per wire center. Alternatively, the plan may comply with a prior regulatory determination that a different level of disaggregation is appropriate.

2. If the appropriate regulatory authority has previously adopted a method of disaggregation, the plan uses the rationale previously adopted.

3. The plan uses a rationale that is reasonably related to the cost of providing service for each cost zone within each disaggregated category (HCL, LSS, LTS).

4. If the plan uses a benchmark, it must be generally consistent with how the total study area level of support for each category of costs (HCL, LSS, LTS) is derived, to compare the disaggregated costs for determining support for each cost zone.

5. The filing must provide a description of the rationale used, including the methods and data, and a discussion of how the plan complies with the self-certification guidelines. The filing need not contain a complete cost study. If the plan uses a benchmark, the filing must explain what the benchmark is and how it was determined. The plan must show a per line amount of support for each element in each zone.

B) The plan becomes effective upon self-certified filing.

C) Self-certification lasts for at least four years from the effective date, unless during that time the regulatory authority requires, on its own motion or upon petition by an interested party, the disaggregation of support, grants ETC status below the study area level, state or federal laws or regulations change, or if a change in ownership occurs.

D) At any time while in effect, the plan is subject to complaint by interested parties before regulatory authority on the grounds that it does not comply with the requirements above. The relevant regulatory administrative procedures (including burden of proof allocation and availability of discovery) will apply to such complaints.

The Task Force recognizes that the state commission has authority to determine whether more than one ETC should be designated in an area served by a Rural Carrier and that the responsibility and process for changing the ETC designation area to a geographic area other than a Rural Carrier's study area are as set forth in Section 214(e)(5) and the FCC's rules. However, the Task Force recommends that the level of disaggregation of support be considered in determining whether to certify new ETCs for a service area other than a full Rural Carrier ETC study area.

B. Portability Implementation

The Task Force's principles stated that any support mechanisms recommended should be consistent with extending the benefits of a competitive telecommunications market to rural or insular areas, and should be competitively neutral. The previous section discussed the need to disaggregate support and target that support to high-cost areas. In this section, the Task Force addresses issues which must be resolved in order to determine available per line support and to make that support available to all ETCs in a transparent and competitively neutral manner.

1. Per Line Support

The Task Force has recommended that universal service support for Rural Carriers continue to be based on the embedded costs of the incumbent carrier. The Task Force has also recommended that support be disaggregated and targeted to high cost areas. Because per line support will be based on embedded costs, because these costs will change each year, and because the number of customers in each area will change, the per line support available for each area will also change.[67]

The Task Force has recommended that per line support available to an incumbent Rural Carrier continue to change based on changes in costs. The Task Force has also recommended that once an additional ETC is designated and begins providing service in a Rural Carrier's study area, that per line support for both the ILEC and the CETC be frozen and grown by the annual RGF. The procedures for determining per line support for all carriers are set forth in Section IV(B)(1)(c) above. The Task Force believes that its recommended approach will continue to provide appropriate incentives for investment in rural America, while at the same time providing fair and reasonable procedures to facilitate competitive entry.

2. Transparency of Universal Service Support

As discussed above, the Task Force recommends that federal universal service support per study area continue to be based on embedded costs, but be disaggregated. Because embedded support will change from year to year, it is very important that per line support for each area of each company, and the basis of disaggregation for each company, be readily available so that potential competitors may make reasonable decisions about whether to enter an area served by a Rural Carrier. Once a CETC is providing the supported services in an area served by a Rural Carrier, the CETC would receive the same per-line support as received by an incumbent Rural Carrier in the disaggregated area.

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[67] In this respect the method of support recommended by the Task Force differs from the mechanism adopted by the FCC for non-Rural Carriers. Under the non-rural mechanism per line support for each area is established by the Synthesis Model. The amount of per line support available does not change until the model is run again, presumably some years hence.

The amount of explicit universal service support that the ILEC receives[68] should be available for review, as is currently done today, via the FCC's web site.[69] Public information of the per-line universal service support would allow competitors to obtain information necessary for business planning purposes. The Task Force recommends that this transparency of support continue. Since the support would be disaggregated, the public information would need to contain information on the basis of the relative distribution of the ILEC's per-line support.

3. Frequency of Reporting and Lag in Support

The entry of a competitive carrier into a Rural Carrier's service area means the number of lines served by the ILEC and the CETC within that area may change in a dynamic manner. Issues concerning the frequency and method of line count reporting were raised by several parties. Since the competitive inroad of the CETC usually begins with a slow ramp-up as customers are signed on for service, customer additions are likely to occur at anytime. Similarly, to the extent customers are replacing an ILEC service with a CETC service, the ILEC's line count can decline precipitously throughout the same period. The Task Force discusses frequency of line count reporting in White Paper 5 "Competition and Universal Service."

The Task Force recommends that the interval between the provision of service and receipt of universal service funding (known as the "lag") should be as short as technically and administratively feasible to ensure provision of universal service. In addition, the line count submissions to the federal universal service fund administrator must be sufficiently sensitive to mid-period competitive activity. Thus, continuing support for the ILEC for a whole period when it is not serving the customer for the whole period, coupled with the failure to compensate the CETC for the portion of the period that it is providing service may constitute a barrier to entry for the CETC. The Task Force recommends using the average of the quarter (i.e., beginning of quarter plus end of quarter divided by two) data.

4. Identification of Service Locations

If a carrier using wireless mobile technologies is designated as an ETC in an area served by a Rural Carrier, an issue arises regarding the location of the customer. The local service areas and network configurations for wireless mobile services may be significantly different than for wireline services. Since support may be disaggregated below the study area or wire center level and must be used in accordance with Section 254(e), the issue arises of how to relate a wireless mobile (i.e., non-fixed location) customer to the proper ILEC wire center, and to the appropriate sub-zone in the wire center, if any.

The Task Force recommends that the wireless carrier use the customer's residential or business location as the basis for determining in which disaggregation zone the customer resides for purposes of universal service support implementation. The Task Force recognizes that the use of

[68] Explicit universal service support would include any explicit support as discussed in HCF III.
[69] *See* www.fcc.gov/ccb/universal_service/quarter.html.

any location address could allow arbitrage of the universal service support system. The Task Force recommends that the FCC establish a reasonable method for determining customer location for wireless customers. The FCC or other appropriate regulatory authority should retain authority to prevent misuse of wireless customer locations and assure that universal service support is used in accordance with Section 254(e).

5. Supported Lines

The Task Force recommends continuing provision of support to all lines in areas served by Rural Carriers, as opposed to supporting only primary lines. This is consistent with current universal service procedures.[70]

6. Stranded Costs

The previous sections above have discussed how to introduce competition into areas served by Rural Carriers. However, the introduction of competition raises the possibility of not only loss of customers by incumbent Rural Carriers, but also loss of historic universal service support. A Rural Carrier that experiences significant line losses to a competitor may face the problem of un-recovered investment, also known as "stranded costs." In White Paper 5 the Task Force discussed the "stranded cost" issue, which is an issue that is subject to a high degree of controversy and disagreement. The Task Force recommends that the FCC address the "stranded cost" issue.[71]

VI. RECOMMENDING CLAUSES

For the reasons discussed herein, this Rural Task Force, appointed by the Federal-State Joint Board on Universal Service, pursuant to Section 254(a)(1) and Section 410(c) of the Communications Act of 1934, as amended, 47 U.S.C. Sections 254(a)(1) and 410(c), recommends that the Federal-State Joint Board recommend to the Federal Communications Commission adoption of the proposals described above relating to federal high-cost universal service support mechanisms for Rural Carriers. The elements of this comprehensive package should be considered in concert with each other and implemented immediately.

[70] *See* White Paper 5.
[71] *See* White Paper 5 for further discussion.

Appendix A - Signatory Rural Task Force Members[72]

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[72] Several appointees were not present or involved during the final months of meetings and conference calls of the Task Force. Because they did not take part in the final deliberations and because the Task Force had agreed early on that they must be present to vote, several appointees' names do not appear on the Recommendation signature page.

Appendix B - Meetings and Conference Calls

The Task Force conducted its business through a series of face-to-face meetings and periodic conference calls. The minutes of these sessions may be found at www.wutc.wa.gov/rtf.

The meetings of the Task Force included:

July 29, 1998 in Seattle, Washington
September 23, 1998 in Washington, D.C.
December 10-11, 1998 in Washington, D.C.
March 4-5, 1999 in Tucson, Arizona
June 24-25, 1999 in Washington, D.C.
September 30-October 1, 1999 in Portland, Maine
January 13-14, 2000 in Washington, D.C.
March 23-24, 2000 in Washington, D.C.
May 25-26, 2000 in Anchorage, Alaska
July 20-21, 2000 in Seattle, Washington
August 24-25, 2000 in Denver, Colorado
September 20-22, 2000 in Washington, D.C.

The Task Force held conference calls on the following dates:

1998: August 25, November 17

1999: January 13, February 3, May 20, August 27, September 17, November 1, November 23, December 6, December 30

2000: February 29, May 18, June 12, June 19, July 11, August 4, August 7, August 14, August 21, August 31, September 5, September 7, September 11, September 13, September 25, September 26, September 27

In addition, sub-group calls were held on numerous occasions.

Appendix C - List of Rural Task Force White Papers

White Paper 1	"Rural Task Force Mission and Purpose"
White Paper 2	"The Rural Difference"
White Paper 3	"Alternative Mechanisms for Sizing A Universal Service Fund for Rural Telephone Companies"
White Paper 4	"A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies"
White Paper 5	"Competition and Universal Service"
White Paper 6	"Disaggregation and Targeting of Universal Service Support"

Note 1: White Paper 4 is released concurrently with the Recommendation to the Federal-State Joint Board on Universal Service.

Note 2: All other White Papers are available at www.wutc.wa.gov/rtf.

Appendix D - Example of the "Safety Valve" Mechanism for the Mergers and Acquisition Cap

1. An appropriate "safety valve" mechanism that would meet the Task Force principles for exchanges that are sold or transferred. The following example illustrates how the "safety valve" mechanism should work.

2. Sold/transferred exchanges acquired by an entity would be designated as a new study area within the state.

3. New study areas thus created that meet the definition of a "rural telephone company" (Rural Carrier) under the 1996 Act will be eligible for treatment under this mechanism.

4. Universal service support provided to these study areas served by Rural Carriers would not be included in the Rural Carrier indexed HCL fund cap.

5. Loops in these study areas would not be included in the calculation of the Rural Growth Factor.

6. Universal service support transferable to the study area under the provisions of Section 54.305 would be available to these study areas.

7. In addition to the universal service support available under Section 54.305, additional HCL support related to new investment in these study areas would be provided in accordance with the following calculations:

    a. At the end of the first year of operations a study area HCL "expense adjustment" using the existing rules would be calculated. This amount would become the "index year expense adjustment."

    b. At the end of each subsequent year a study area HCL "expense adjustment" using the existing rules would be calculated and would be compared to the "index year expense adjustment."

    c. Fifty percent of any positive difference between the subsequent year "expense adjustment" and the "index year expense adjustment" would be designated as the "sale/transfer safety valve expense adjustment" and would be provided as universal service support to the study area in addition to amounts available under Section 54.305.

8. The sum of the "sale/transfer safety valve expense adjustments" for all study areas eligible for the adjustment would not exceed 5 percent of the indexed HCL fund cap for Rural Carriers.

9. Per loop equivalent amounts of the "sale/transfer safety valve expense adjustment" would be portable to a CETC operating within the study area.